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1959

1899

Annual Report to Shareholders

NATIONAL TEA CO.

1959

Our 60th Anniversary Year

1899 1959

NATIONAL TEA CO.

HOME OFFICE:
1000 N. CROSBY STREET
CHICAGO 10, ILLINOIS

National Branch Offices and Warehouses • Chicago • Minneapolis • Milwaukee • Indianapolis • Detroit • Kalamazoo • St. Louis • New Orleans • Memphis • Davenport • Denver • Sioux City

National Food Stores Serving The States of • Alabama • Arkansas • Colorado • Illinois • Indiana • Iowa • Louisiana • Michigan • Minnesota • Mississippi • Missouri • Nebraska • North Dakota • Ohio • South Dakota • Tennessee • Wisconsin • Wyoming

DIRECTORS

NORBERT L. CHAPLICKI
Vice President

JOHN F. CUNEO*
President of The Cuneo Press, Inc.

D. LLOYD McCLOCKLIN
(Resigned January 11, 1960)
Assistant Secretary of Loblaw Groceterias, Ltd.

HARLEY V. McNAMARA*
President and Chief Executive Officer

ROY S. McPHERSON
Partner, Thorne, Mulholland, Hawson & McPherson (chartered accountants)

RICHARD G. MEECH
Vice President, Secretary and Treasurer of Loblaw Groceterias Co., Ltd.

GEORGE C. METCALF*
Chairman of the Company and President of Loblaw Groceterias Co., Ltd.

CLAUDE H. WEBSTER
Executive Vice President

W. GARFIELD WESTON
Chairman of the Board of George Weston, Ltd.

**Members of the Executive Committee*

OFFICERS

GEORGE C. METCALF
Chairman of the Company

HARLEY V. McNAMARA
President and Chief Executive Officer

CLAUDE H. WEBSTER
Executive Vice President

NORBERT L. CHAPLICKI
Vice President

VAL S. BAUMAN
Vice President

IRA O. SHY
Vice President

GEORGE E. HOUSTON
Vice President

HAROLD L. WILKENS
Vice President

E. GUY LOY
Vice President

NORMAN A. STEPLETON
Vice President

WILLIAM T. MORGAN, JR.
Vice President and Secretary

CHARLES WOODING
Treasurer

ROBERT E. KOEHLER
Comptroller and Asst. Treasurer

TRANSFER AGENTS

THE FIRST NATIONAL BANK OF CHICAGO
Chicago, Illinois

THE CHASE MANHATTAN BANK
New York, New York

REGISTRARS

CONTINENTAL ILLINOIS NATIONAL BANK & TRUST COMPANY OF CHICAGO
Chicago, Illinois

CHEMICAL BANK NEW YORK TRUST COMPANY
New York, New York

TRUSTEES AND PAYING AGENTS

3½% Debentures
Chemical Bank New York Trust Company
New York, New York

5% Debentures
Morgan Guaranty Trust Company
New York, New York

★ ★ ★
NATIONAL
FOOD STORES

Financial Highlights

	1959 (52 weeks)	1958 (53 weeks)
OPERATIONS:		
Sales	$829,518,276	$794,162,135
Income before income taxes	18,145,208	17,741,543
Federal income taxes	9,120,000	8,900,000
Net income	9,025,208	8,841,543
Net Income—Percent to sales	1.09%	1.11%
Cash dividends	5,266,038	4,371,576
Earnings retained in the business	3,759,170	4,469,967
INVESTMENT:		
Working capital	43,954,849	46,446,339
Plant and equipment	67,276,442	62,597,533
Long-term debt	32,070,000	39,485,000
Common shareholders' equity	78,847,439	68,858,804
PER COMMON SHARE (1958 adjusted for 3 for 1 split on March 26,1959):		
Income (based on average shares outstanding)	1.32	1.34
Dividends	.77	.67
Equity	11.21	10.33
Shares outstanding	7,033,990	6,664,254
TOTAL STORES		
—at end of year:	910	932

Management Report to the Shareholders

H. V. McNamara
President

for 1959

The year 1959 will be recorded as realistically significant for the records established in sales and earnings from within our territorial boundaries, and without the benefits realized in previous recent years from expansion through acquisition of other regional food chains or groups of stores.

Although we did not find the opportunities sufficiently attractive to your board of directors for expansion on a profitable basis through the acquisition route, your company did continue its aggressive program of modernizing, relocating and opening stores in our various branch operations, which contributed substantially to the continuance of our growth pattern. These were the material accomplishments, which mark 1959 as our best year, and rightly so, because 1959 was also our 60th Anniversary year.

The first National Tea Store, and it was called that, was opened in Chicago on December 9, 1899, located at 2718 W. North Ave., just a short distance from our present home office, according to our historians. We are told that the intial investment in this store was $5,400, and included the store building, the fixtures and the inventory, which was primarily composed of tea, coffee, spices, butter and eggs. While cash registers were unknown, or at least a not-to-be-afforded luxury in those days, we understand that the opening day's record sales of this first National Tea Store were $4.65.

From this modest beginning, and in less than the life span of man, your company has grown until at this reporting, 60 years later, one National Tea Store has become 910 modern National Food Stores. That one founder-investor has become 12,000 shareholders living in 49 of the 50 United States of America, and that original initial investment of $5,400 has grown to an invested capital of $80,000,000. From serving a few people in one small Chicago neighborhood, National Food Stores now serve approximately 5,000,000 customers in 18 of the most densely populated, best business states of the nation. Our 60th Anniversary finds us the fifth largest food chain in America, and the two or three people, that were necessary to serve the customers of the first National Tea Store have grown to a great family of more than 24,390 employees, who make up our aggressive organization of today.

While we review with considerable pride our progress in the last 60 years, we likewise are cognizant of the fact that such growth is only in line with the pattern of the growing economy of our nation, and the decade of the 60's should provide opportunities for the continued growth and progress of our business, as well as that of our compatriots and competitors, in order to better serve the ever increasing needs of the expanding population of the nation.

That there is still opportunity for substantial expansion of our company is best indicated by the fact that, although accumulatively our dollar sales volume appears impressive, it represents less than 5% of the total food sales in the 18 states in which our stores are operated, and in no branch territory do we enjoy more than 20% of the total business potential. You are reminded of these facts to demonstrate the great opportunity we face for the future in further improving the stature of your company, and to correct any false impression, that might have been created in the minds of our shareholders as a result of the Federal Trade Commission complaint filed against your company last year, charging monopolistic tendencies due to our aggressive expansion and acquisition program in recent years under present management.

Our report on operations for 1959 shows continued progress in the pattern of the last 15 years. However, in comparing results for 1959 with the year previous, we call to your attention the fact that our operating calendar for 1959 comprised a normal 52 week year, whereas there were 53 weeks in our fiscal year 1958.

Sales

The year 1959 could have been a difficult sales year in the food industry, due to lower food prices, strikes and other problems, with which we found it necessary to contend. The drop in food prices generally is evidenced in the Bureau of Labor Statistics Food Price Index, which was 115.9 for 1959 as compared with 118.8 in 1958. Much of this decline in the food price index resulted from lower meat prices, and we are sure our shareholders realize that meats represent a substantial portion of our total overall business. Average meat prices in National Food Stores were 5% lower in 1959 than the year previous. Strikes also took their toll of sales and profits in 1959, and we would have even a larger increase to report, had it not been for the industry-wide strike in Minneapolis early in the year, and the general steel strike affecting so many of our branch areas later in the year.

In spite of these difficulties, our total sales for 1959 were at an all time high of $829,518,276, which was a gain of 4.45% over the previous year's record of $794,162,135. Average sales per store likewise increased to $17,300 per week as compared with $16,500 per week in 1958.

Profits

Net profit crossed another million mark in 1959 to reach $9,025,208 or $1.32 per share on the average number outstanding during the year. This represents a gain of 2.08% over the $8,841,543 earned in the 53 weeks of 1958. Per share earnings are down slightly, because of the substantial increase in outstanding shares resulting from the conversion of $6,248,000 principal amount of 3½% debentures.

Only 1.09% of the 1959 sales dollar remained after deducting the costs and expenses of doing business and Federal Income Taxes. We are not satisfied with this slim margin of profits, and are doing everything in our power to improve efficiency and reduce costs. In this respect, industry statistics show that our costs are well below the average of reporting food chains.

Continued on Page 3

# of National Tea Co.

Food chain profit margins traditionally have been low, because rapid turnover generally provides for a satisfactory return on investment. It is becoming increasingly apparent however, that the struggle for business in this highly competitive field has reached the point in many areas, where too many stores are offering too many costly, promotional plans, short sighted attractions and excessively low marginal price structures in their efforts to capture a greater share of the available business.

Dividends and Shareholders' Equity

Cash dividends of 50c per share were paid on March 1, 1959. The company's shares were split 3 for 1 on March 26, 1959, and dividends were increased 20% to 20c per share paid June 1st, September 1st and December 1st. Total dividends paid in 1959 amounted to 77c per share on the basis of the new shares, after the 3 for 1 split.

Shareholders' equity at the close of 1959 was $78,847,439 or almost $10,000,000 greater than the beginning of the year. Of this increase, $3,759,170 represents the balance of 1959 earnings retained in the business, and the remainder is largely the result of conversions from 3½% debentures to common stock. We welcome these new shareholders, who helped swell the ranks at year end to 9,870 shareholders of record, plus an estimated additional 2,200 shareholders included in brokers accounts.

Financial

Net working capital declined $2,491,490 in 1959 as we continued to allocate funds into new and larger stores. While this balance is lower than previously, it does reflect an improvement in our cash turnover, which is another measure of operating efficiency. Year end bank loans of $2,500,000 largely resulted from the fact that the New Year Holiday made is impossible to get end-of-the-week cash from the stores into the banks.

Long term debt was reduced substantially in 1959 through conversions to common stock and normal retirements, and now represents less than 30% of total capitalization. Additional conversions and debt retirements in 1960 will further reduce this ratio to possibly 24% of anticipated capitalization at year end.

Following is a summary of the source and disposition of working capital funds in 1959:

Source of Funds:

Net Income	$ 9,025,208
Deferred Federal Income Taxes (related to accelerated depreciation)	293,000
Sale of common shares to optionees	402,140
	$ 9,720,348

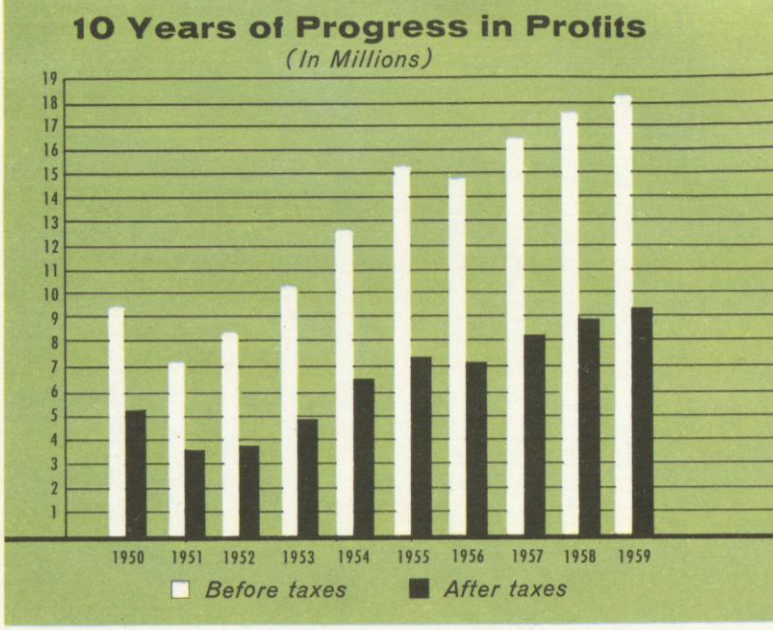
Disposition of Funds

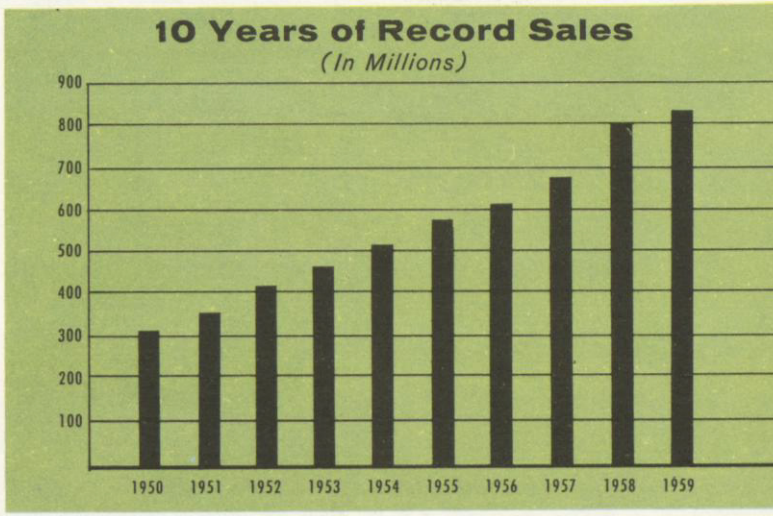
Net expenditure for plant and equipment in excess of depreciation and amortization	$ 4,462,309
Acquisitions of other business	216,600
Retirement of long term debt	1,167,000
Cash dividends on common shares	5,266,038
Other dispositions—Net	1,099,891
	$12,211,838
Decrease in Working capital	$ 2,491,490

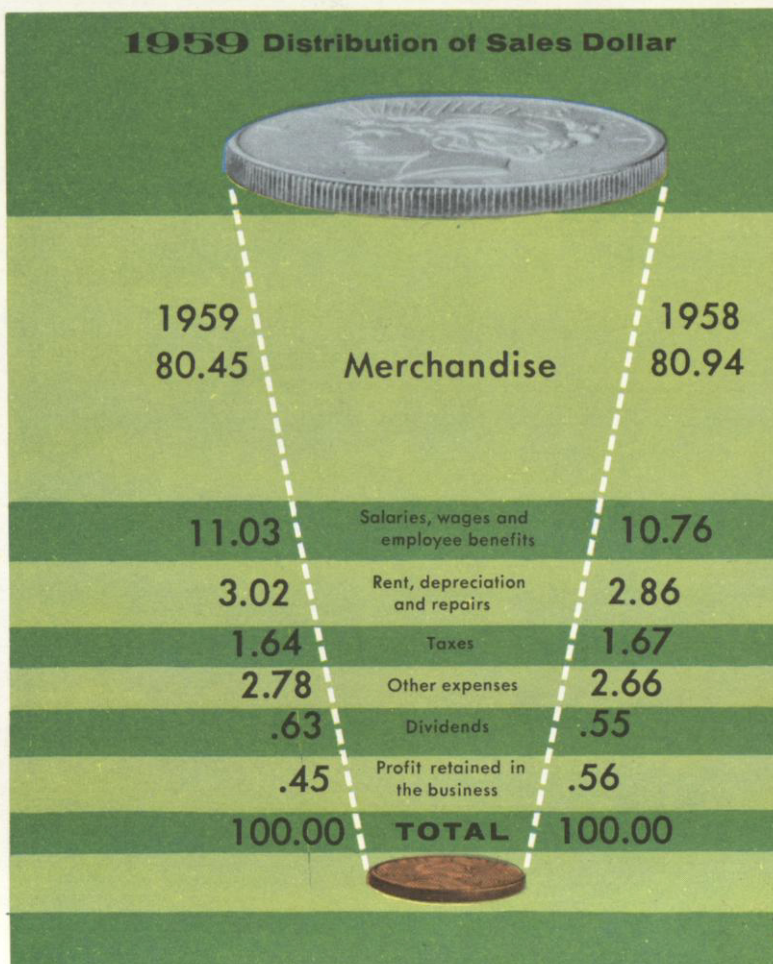
Operations

During 1959 we opened a total of 69 new stores, of which 53 were new locations and the balance relocations of stores we have outgrown. A total of 91 stores were closed due to reloca-

Continued on Page 4







tions or because they offered no contribution to sales and profits for future operation beyond 1959. As the year ended we had negotiated leases for an additional 100 new stores in our various branch operating areas, almost two-thirds of which we anticipate opening during 1960.

While the number of new stores opened in 1959 was less than 1958, when we had 95 new store openings, they represented a greater total investment due to the expanded size of stores now necessary to cope with competition, plus increased investment per store for fixtures and equipment to improve services and reduce labor costs, as well as provide greater perishable food merchandising facilties in the fresh and frozen lines.

Organization and Personnel

Several important managerial changes were made in 1959 under our policy of providing new opportunities for younger men, who gain experience in our business. New branch managers were elevated in Indianapolis, Kalamazoo and Minneapolis, and the demand for enthusiastic, capable leaders in the food business continues unabated. We continue to encourage young people to seriously consider the opportunities in this challenging and growing industry, when planning their careers.

Profit Sharing

The Board of Directors has approved for your consideration the installation of a Salaried Employees Profit Sharing and Savings Plan, which we believe will stimulate increased interest, efficiency and initiative among its salaried employees, and fulfill the company's long-standing need for a retirement program of broad coverage. Our study of similar programs in the food chain and other industries indicates that the enthusiasm for such a program by responsible employees is such that the cost is more than recoverable in improved operations. At least this is our hope and expectation. As was the case in the stock option plans, which you approved in 1957 and 1959, your president has asked not to be included in the program.

Outlook for 1960

We are confident that National Food Stores will continue to lead the way in quality, service and economy, and thereby obtain full participation in the continued growth of the food business in 1960 and the decade that lies ahead.

This is our goal, and with the help of 24,390 loyal employees, we fully expect that new sales and profit records for National Tea Co. will again be set in 1960.

H. V. McNamara

10 Year Review of Financial Highlights

Continued Progress Report 1950-1959

YEAR	1959	1958 53 WEEKS	1957	1956	1955	1954	1953	1952	1951	1950
							Following reported in thousands (000 omitted)			
OPERATIONS:										
Sales	$829,518	$794,162	$681,132	$617,636	$575,585	$520,300	$462,282	$405,220	$361,321	$315,219
Income Before Federal Taxes	18,145	17,742	16,774	14,938	15,237	12,739	10,048	8,408	7,203	9,765
Federal Income Taxes	9,120	8,900	8,720	7,930	8,000	6,220	5,150	4,690	3,595	4,550
Net Income	9,025	8,842	8,054	7,008	7,237	6,519	4,898	3,718	3,608	5,215
Percent to Sales	1.09%	1.11%	1.18%	1.13%	1.26%	1.25%	1.06%	.92%	1.00%	1.65%
Cash Dividends:										
Preference	—	—	—	—	1	212	450	504	266	107
Common	5,266	4,372	4,293	4,241	4,198	2,961	2,594	2,498	2,466	2,001
Earnings Retained Before Special Items	3,759	4,470	3,761	2,767	3,038	3,346	1,854	716	876	3,107
							Following reported in thousands (000 omitted)			
INVESTMENT:										
Working capital	43,955①	46,446①	51,039①	42,633	44,122	34,118	30,002	22,586	24,002	16,567
Plant and equipment	67,276	62,598	53,834	43,143	38,530	29,499	25,457	19,413	17,293	15,118
Long-term debt	32,070	39,485	42,539	30,103	30,700	16,200	16,200	4,200	4,600	5,000
Common shareholders' equity	78,847	68,859	61,801	56,286	53,499	45,929	35,538	30,239	28,913	28,285
Shares outstanding	7,034②	2,221	2,167	2,121	2,120	1,971	1,707	1,568	1,542	1,541
							(1958 and prior years adjusted for 3 for 1 split on March 26, 1959)			
PER COMMON SHARE										
Income (based on average shares outstanding)	1.32	1.34	1.25	1.10	1.18	1.14	.91	.69	.72	1.11
Dividends	.77	.67	.67	.67	.67	.53③	.53	.53	.53	.53
Equity	11.21	10.33	9.51	8.85	8.41	7.77	6.94	6.43	6.25	6.13
TOTAL STORES										
At year end	910	932	883	761	744	711	688	765	624	634

① Prepaid expenses included in working capital since 1957.

② $4 par value shares after 3 for 1 split on March 26, 1959.

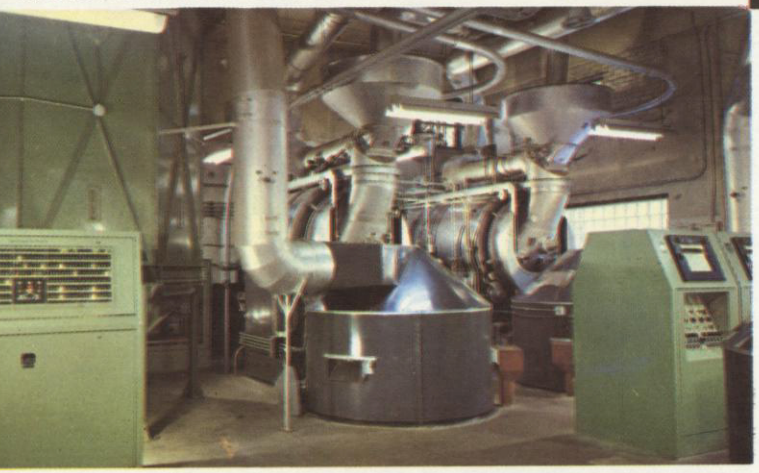
③ Plus extra 2% stock dividend paid to shareholders of record on November 16, 1954.

1959

Consolidated Balance Sheet

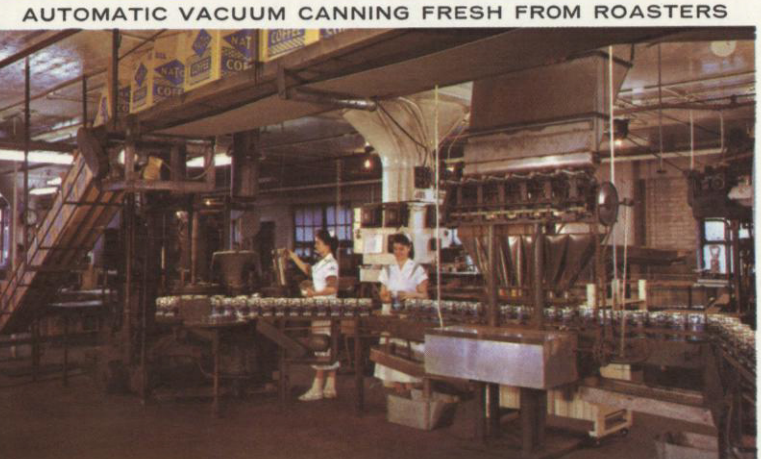
National Tea Co. and Subsidiaries

NATIONAL'S NEW COFFEE ROASTING PLANT IN CHICAGO



PUSH BUTTON AUTOMATION FOR UNIFORM BLENDING

AUTOMATIC VACUUM CANNING FRESH FROM ROASTERS



ASSETS

CURRENT ASSETS:

Cash . . . . .

Accounts receivable . . . . .

Inventories, at lower of cost or market—

Merchandise . . . . .

Supplies . . . . .

Prepaid expenses . . . . .

Total current assets . . . . .

OTHER ASSETS . . . . .

PLANT AND EQUIPMENT, at cost, less reserves for depreciation

Land . . . . .

Buildings . . . . .

Fixtures and equipment . . . . .

Reserves for depreciation . . . . .

Leasehold improvements, less amortization . . . . .

Excess of cost of investment in branches and subsidiaries over underlying book values at dates of acquisition—in process of amortization . . . . .

Jan. 2, 1960	Jan. 3, 1959
$ 19,471,956	$ 19,372,767
4,571,463	4,218,316
56,635,507	54,824,715
1,679,681	1,611,476
3,585,761	3,261,674
$ 85,944,368	$ 83,288,948
$ 2,762,364	$ 2,091,860
$ 1,874,439	$ 1,964,113
9,965,630	9,951,711
71,532,557	66,073,735
(32,450,064)	(30,237,795)
14,934,368	13,181,507
$ 65,856,930	$ 60,933,271
1,419,512	1,664,262
$ 67,276,442	$ 62,597,533
$155,983,174	$147,978,341

LIABILITIES

	Jan. 2, 1960	Jan. 3, 1959
CURRENT LIABILITIES:		
Bank loans	$ 2,500,000	$ —
Current maturity of long-term debt	1,166,000	1,155,000
Accounts payable	27,128,386	24,766,404
Accrued liabilities	6,275,037	4,864,726
Federal income taxes	4,920,096	6,056,479
Total current liabilities	$ 41,989,519	$ 36,842,609
LONG-TERM DEBT:		
3½% promissory notes, due 1969	$ 774,000	$ 861,000
4% promissory notes, due 1973	13,500,000	14,100,000
5% sinking fund debentures, due 1977	11,040,000	11,520,000
3½% sinking fund subordinated debentures, due 1980 (convertible into common shares through 1965)	6,756,000	13,004,000
	$ 32,070,000	$ 39,485,000
RESERVES:		
Deferred Federal income taxes (relating to accelerated depreciation)	$ 2,823,000	$ 2,530,000
Self-insurance	250,000	250,000
Minority interest in consolidated subsidiary	3,216	11,928
	$ 3,076,216	$ 2,791,928
CAPITAL STOCK AND SURPLUS:		
Common shares—	1959 $4 par value	1958 $5 par value
Authorized	10,000,000	4,300,000
Issued	7,059,698	2,225,298
	$ 28,238,792	$ 11,126,490
Reserved for options and conversions	574,478	290,641
Paid-in surplus	8,949,133	19,557,760
Earned surplus	42,111,388	38,352,218
	$ 79,299,313	$ 69,036,468
Less—Cost of treasury common shares— 1959—25,708 shares; 1958—3,880 shares	451,874	177,664
	$ 78,847,439	$ 68,858,804
	$155,983,174	$147,978,341

See notes to financial statements.

Statements of Consolidated Income and Surplus

NATIONAL TEA CO. and SUBSIDIARIES

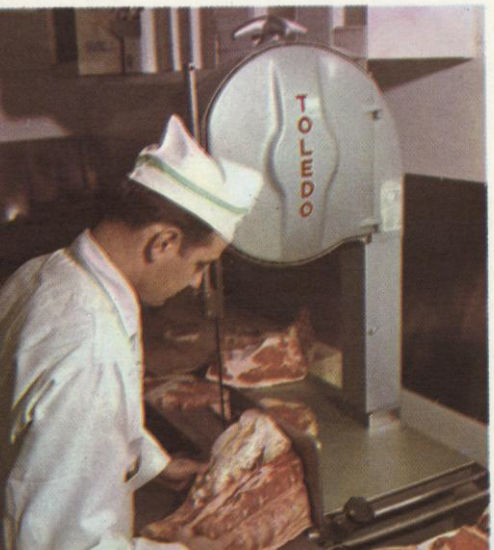
INCOME	1959 52 weeks	1958 53 weeks
SALES	$829,518,276	$794,162,135
COSTS AND EXPENSES		
Cost of sales and expenses	$788,355,417	$755,088,835
Depreciation and amortization	8,515,509	7,759,208
Rent	12,816,739	11,672,077
Interest	1,685,403	1,900,472
Federal income taxes	9,120,000	8,900,000
	$820,493,068	$785,320,592
NET INCOME	$ 9,025,208	$ 8,841,543

EARNED SURPLUS	
BALANCE AT JANUARY 3, 1959	$ 38,352,218
NET INCOME FOR 52 WEEKS	9,025,208
	$ 47,377,426
DEDUCT—Dividends paid on common shares ($.77 per share)	5,266,038
BALANCE AT JANUARY 2, 1960	$ 42,111,388

PAID-IN SURPLUS	
BALANCE AT JANUARY 3, 1959	$ 19,557,760
ADD OR (DEDUCT)	
Excess of market value over cost of treasury common shares used for promotion and other purposes	$ 3,173
Excess of cost over option price of treasury common shares sold to officers and employees	(14,212)
Excess of proceeds over par value of new common shares sold to officers and employees under 1957 stock option plan	275,591
Excess of principal amount of debentures retired over par value of common shares issued in conversion	4,944,688
Amount transferred to capital stock account and expenses relating to 3 for 1 stock split	(15,817,867)
BALANCE AT JANUARY 2, 1960	$ 8,949,133

See notes to financial statements.

1959



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Notes to Financial Statements—January 2, 1960

Long-term Debt

The 3½% promissory notes require annual prepayments of $86,000 through 1968.

The 4% promissory notes require annual prepayments of $600,000 in 1960 and 1961, $700,000 in 1962 through 1964 and $1,000,000 in 1965 through 1972.

The 5% sinking fund debentures require mandatory sinking fund payments sufficient to retire $480,000 debentures in each of the years 1960 through 1972 and $600,000 of debentures in each of the years 1973 through 1976. Additional optional sinking fund payments may be made each year sufficient to retire at the same price debentures not in excess of 50% of the mandatory retirements.

Annual sinking fund requirements to maturity of the 3½% subordinated debentures have been satisfied by conversions into common shares. The remaining debentures are convertible into common shares at $18.31 per share through November 1, 1962 and $19.15 per share through November 1, 1965.

Dividend Restriction

Earned surplus of $24,511,924 is restricted as to the payment of cash dividends on and the purchase of common shares at January 2, 1960; net current assets remaining after giving effect to the payment of dividends or reacquisition of stock must equal at least $25,000,000.

Stock Options

As of January 2, 1960, there were 205,499 unissued common shares reserved for employee stock options under the plans approved by shareholders in 1957 and 1959. Each option expires five years after grant but not later than January 1, 1966 for the 1957 Plan and January 1, 1969 for the 1959 Plan. 20% of the shares covered by each option becomes exercisable ten months after grant of the option and an additional 20% becomes exercisable each year thereafter.

At January 2, 1960, options for 173,399 shares were outstanding at prices ranging from $11.92 to $21.38 per share, of which 10,039 shares were exercisable.

Profit Sharing

A salaried employees' profit sharing and savings plan has been submitted for shareholders' approval at the annual meeting on March 21, 1960, under which the company's contribution beginning in 1960 will be 2½% of net income before provision for profit sharing and Federal income taxes.

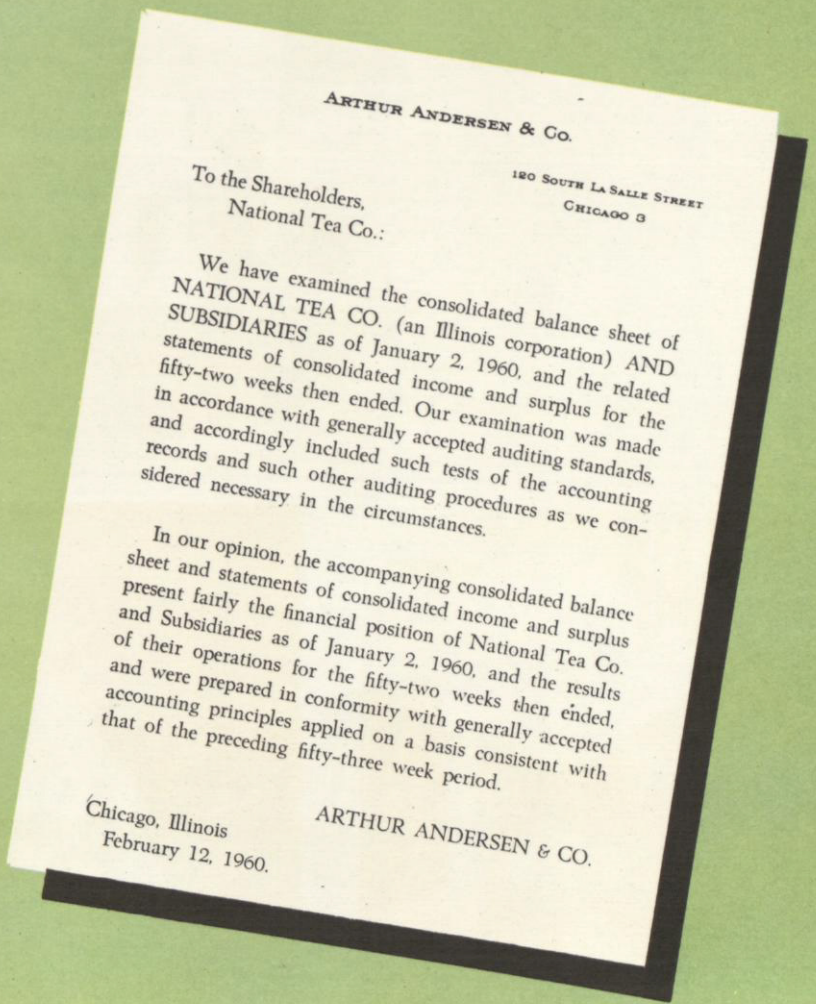
Litigation

In March, 1959, the Federal Trade Commission filed a complaint against the Company alleging that several acquisitions of additional retail grocery stores violated Section 5 of the Federal Trade Commission Act and Section 7 of the Clayton Act. The hearing has been postponed several times at the request of the Government and is now scheduled to be heard on April 4, 1960 before an examiner of the Federal Trade Commission.

The stockholders' suit filed against the company in 1956 (described in previous reports) was dismissed in 1959 at the request of the plaintiff.

Lease Commitments

At January 2, 1960, the company and its subsidiaries have 775 leases expiring after three years from that date (some of which contain percentage rental clauses) with minimum annual rentals amounting to approximately $13,163,000 exclusive of taxes, insurance and maintenance payable by the lessee. Of this amount, approximately 72% applies to leases expiring within 10 years.



ARTHUR ANDERSEN & Co.

120 South La Salle Street
Chicago 3

To the Shareholders,
National Tea Co.:

We have examined the consolidated balance sheet of NATIONAL TEA CO. (an Illinois corporation) AND SUBSIDIARIES as of January 2, 1960, and the related statements of consolidated income and surplus for the fifty-two weeks then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated balance sheet and statements of consolidated income and surplus present fairly the financial position of National Tea Co. and Subsidiaries as of January 2, 1960, and the results of their operations for the fifty-two weeks then ended, and were prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding fifty-three week period.

Chicago, Illinois
February 12, 1960.

ARTHUR ANDERSEN & CO.

1959

1899

FRIEND OF THE FAMILY

NATIONAL FOOD STORES

FOR 60 GREAT YEARS